G.N. 5586

ACCOUNTING AND FINANCIAL REPORTING COUNCIL ORDINANCE (Chapter 588)

Notice is hereby given that pursuant to sections 13 and 37H of the Accounting and Financial Reporting Council Ordinance (Chapter 588), the Accounting and Financial Reporting Council publishes the following Guidelines for Exercising the Power to Impose a Pecuniary Penalty for PIE Auditors and Registered Responsible Persons which shall become effective on 7 October 2022 and supersede the previous version of such guidelines.

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Guidelines for Exercising the Power to Impose a Pecuniary Penalty for PIE Auditors and Registered Responsible Persons

(With effect from 7 October 2022)

Introduction

1. These guidelines are made pursuant to sections 13 and 37H of the Accounting and Financial Reporting Council Ordinance (Cap. 588) ("**AFRCO**") to indicate the manner in which the Accounting and Financial Reporting Council ("**AFRC**") will exercise its powers to impose a pecuniary penalty on a public interest entity ("**PIE**") auditor or a registered responsible person of a registered PIE auditor (together referred to as "**Regulatees**") pursuant to sections 37D(3)(b)(iv) and 37E(3)(b)(iii) of the AFRCO respectively. Section 37H(1)(b) requires the AFRC to have regard to these guidelines in imposing any pecuniary penalty.

2. Unless otherwise stated, terms defined in the AFRCO shall have the same meanings in these guidelines.

3. These guidelines will be reviewed periodically and (where appropriate) revised in the light of experience. These guidelines cannot deal with every single situation and exceptions will sometimes arise.

Power to order pecuniary penalties for FR misconduct

4. Pursuant to section 37D(3)(b)(iv) of the AFRCO, if the AFRC is satisfied that a person who is or was a PIE auditor has committed FR misconduct, the AFRC may order that person to pay a pecuniary penalty not exceeding the amount which is the greater of—

   (a) $10,000,000; or

   (b) 3 times the amount of the profit gained or loss avoided by the person as a result of the FR misconduct.

5. Pursuant to section 37E(3)(b)(iii) of the AFRCO, if the AFRC is satisfied that a person who is or was a registered responsible person of a registered PIE auditor has committed FR misconduct, the AFRC may order that person to pay a pecuniary penalty not exceeding the amount which is the greater of—

   (a) $10,000,000; or

   (b) 3 times the amount of the profit gained or loss avoided by the person as a result of the FR misconduct.

General approach to determining a pecuniary penalty

6. In determining whether a pecuniary penalty is appropriate and, if so, the amount of pecuniary penalty to be ordered, the AFRC will consider the full circumstances of each case, including the seriousness of the FR misconduct involved and the circumstances of the Regulatee concerned. The AFRC will also have regard to the upper limit on the pecuniary penalty that can be imposed in respect of each FR misconduct.

7. Without prejudice to the matters stated in paragraph 6 above, in undertaking the assessment of whether to impose a pecuniary penalty and the appropriate amount of pecuniary penalty, the AFRC will generally adopt the following approach:

   (a) the AFRC will first assess the FR misconduct including its nature, seriousness, frequency, duration and impact to form a view on the appropriateness of a pecuniary penalty as set out in paragraphs 9 and 10 below; and

   (b) the AFRC will then make any necessary adjustment to take account of any relevant aggravating and mitigating factors and to avoid the effect of putting a Regulatee in financial jeopardy as set out in paragraphs 11 to 15 below.

8. Where a case potentially gives rise to multiple pecuniary penalties, the AFRC will look at the totality of the pecuniary penalties to ensure that they are not disproportionate to the seriousness of the FR misconduct in question for each of the Regulatees.

<u>Step (a): Assessing the FR misconduct</u>

9. In assessing the FR misconduct, the AFRC may consider the factors summarized in the next paragraph. This list is not exhaustive and not all factors will be applicable in a particular case. The AFRC may also consider any other factors, not listed, that are relevant. Having identified the factors that it regards as relevant, the AFRC will decide the relative weight to ascribe to each relevant factor.

10. Factors which the AFRC may consider include:

    The nature and seriousness of the FR misconduct

    (a) the nature, extent and importance of any laws, standards or regulations breached;

(b) whether the FR misconduct was intentional, dishonest, deliberate, reckless or negligent, or involved a failure to act or conduct business with integrity or an abuse of a position of trust;

(c) whether the FR misconduct was engaged in by the Regulatee alone or as a group, and if so the Regulatee's role in that group, including whether the Regulatee caused or encouraged other individuals to commit FR misconduct;

(d) whether the Regulatee facilitated wrongdoing by a third party or collusion with a client;

(e) in the case of a PIE auditor, the effectiveness of its relevant procedures, systems or internal controls and/or its implementation of any relevant Hong Kong Standard on Quality Control (or equivalent);

The frequency and duration of the FR misconduct

(f) whether the FR misconduct was isolated, or repeated or ongoing;

(g) if repeated or ongoing, the duration of the FR misconduct;

The impact of the FR misconduct

(h) whether the FR misconduct damaged, or (if known) could have damaged, the public interest and the interest of the investing public;

(i) whether the FR misconduct damaged, or (if known) could have damaged, investor, market and public confidence in the truth and fairness of the financial statements of PIEs;

(j) whether the FR misconduct undermined, or (if known) could have undermined, public confidence in the standards of conduct in general of Regulatees and the reputation of Hong Kong as an international financial centre;

(k) whether the FR misconduct adversely affected, or (if known) could have adversely affected, a significant number of people (such as the investing public), including the loss of significant sums of money; and

(l) the financial benefit derived or intended to be derived from the FR misconduct (the amount of profits gained or intended to be gained or losses avoided or intended to be avoided by the Regulatee, in so far as they can be determined). If the Regulatee has derived any illegitimate financial

benefits or has illegitimately avoided any losses, the AFRC will generally take steps to ensure that no illegitimate gain is retained. The AFRC may also allocate an amount in respect of interest on the benefit obtained or loss avoided.

Step (b): Making necessary adjustment

11. Having assessed the circumstances of the FR misconduct and reached a view on the appropriateness of a pecuniary penalty, the AFRC will then consider whether any adjustments need to be made to take account of any relevant aggravating and mitigating factors (to the extent those factors have not already been taken into account in the AFRC's assessment of the FR misconduct) and to avoid the effect of putting a Regulatee in financial jeopardy.

Aggravating and mitigating factors

12. The list below is not exhaustive and not all factors will be applicable in a particular case. The AFRC will also consider any other factors, not listed, that are relevant. Having identified the factors that it regards as relevant, the AFRC will decide the relative weight to ascribe to each relevant factor.

13. Factors which the AFRC may consider include:

    (a) the degree of cooperation (or non-cooperation) with the AFRC, including whether remedial actions have been taken – please refer to the "Guidance Note on Cooperation with the AFRC" which is available on the AFRC's website (https://www.afrc.org.hk/) for more information;

    (b) whether similar previous FR misconduct by the Regulatee or issues similar or related to the FR misconduct have been identified, and whether appropriate steps had been taken to address any such similar FR misconduct or issues;

    (c) whether the Regulatee has failed to comply with any previous direction or order relevant to the FR misconduct;

    (d) the Regulatee's compliance history and disciplinary record;

    (e) in the case of an individual, the individual's experience in the profession and scope of responsibilities within the PIE auditor;

    (f) in the case of an individual, personal mitigating circumstances;

    (g) prior sanctions imposed or regulatory action taken by other competent authorities; and

(h) result of any concluded civil action taken by third parties.

Financial jeopardy

14. A pecuniary penalty should not have the effect of putting the Regulatee concerned in financial jeopardy. The Regulatee is only required to provide evidence to the AFRC as to the financial situation of the Regulatee where a Regulatee submits that the AFRC's proposed pecuniary penalty may put it, him or her in such a position. In this regard, the AFRC will consider the following:

    (a) in the case of a PIE auditor, the AFRC will have regard to the PIE auditor's size, financial resources and financial strength, as indicated by, for example, the total turnover of the PIE auditor and the effect of the pecuniary penalty on its practice; and

    (b) in the case of an individual, the AFRC will have regard to the individual's financial resources, as indicated by, for example, his or her annual income and assets and the effect of the pecuniary penalty on that individual.

15. However, if a Regulatee takes or has taken deliberate steps to create the false appearance that the pecuniary penalty will place it, him or her in financial jeopardy, e.g. by transferring assets to third parties, this will be taken into account.

Disclaimer

16. The provisions in these guidelines are guiding principles only. They do not in any way limit the discretion of the AFRC to evaluate each case on its own facts and circumstances.

17. For the avoidance of doubt, these guidelines do not purport to set out an exhaustive list of the principles and factors that the AFRC may take into account when imposing pecuniary penalties, and not all of the matters referred to above will be applicable in a particular case.

18. These guidelines do not constitute legal advice. You should seek professional advice if you have any question relating to the application or interpretation of the relevant provisions of the AFRCO.

19. The AFRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using these guidelines or arising from any omission from them.

20. In the event of any inconsistency between this document and the AFRCO, the AFRCO shall prevail.